**Franchise Tax Board**

# SUMMARY ANALYSIS OF AMENDED BILL

Author: AR&T Committee Analyst: LuAnna Hass Bill Number: AB 1742

Related Bills: See Prior Analysis Telephone: 845-7478 Amended Date: April 22, 2003

Attorney: Patrick Kusiak Sponsor: ________

**SUBJECT**: Golden State Scholarshare Trust Technical/Erroneous Refund Interest/Clarify Authority To Use New-Hire Registry Information/ Minimum Franchise Tax/15-Day Disregard Rule

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________________.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ________________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED March 11, 2003, STILL APPLIES.

X OTHER - See comments below.

## SUMMARY

This bill contains Franchise Tax Board (FTB) sponsored proposals that would:

- renumber the tax law code section for the Golden State Scholarshare Trust,
- simplify the computation of interest on erroneous refunds, and
- clarify FTB's authority to use the information contained in the new-hire and contractor registries maintained by the Employment Development Department (EDD) when collecting on Non-Tax Debt Programs (NTD) administered by FTB.

In addition, this bill contains a provision that would clarify that a corporation's period of inactivity of 15 days or less between the date of incorporation and the beginning of its next annual accounting period would be disregarded as a taxable year.

## SUMMARY OF AMENDMENT

The April 22, 2003, amendments would add the provisions discussed in this analysis. Specifically, this bill would clarify:

1. FTB's authority to use the information contained in the new-hire and contractor registries; and
2. that a corporation's period of inactivity of 15 days or less between the date of incorporation and the beginning of its next annual accounting period would be disregarded as a taxable year.

Each provision will be discussed separately.

| Board Position: | | | Legislative Director | Date |
|---|---|---|---|---|
| X S | NA | NP | Jana Howard for Brian Putler | April 25, 2003 |
| SA | O | NAR | | |
| N | OUA | PENDING | | |

## 1. Clarify Authority To Use New-Hire Registry Information

### PURPOSE OF THE BILL

The purpose of this FTB sponsored provision is to clarify FTB's authority to use EDD new-hire and contractor registries for collecting NTD administered by FTB.

### EFFECTIVE/OPERATIVE DATE

This provision would be effective and operative January 1, 2004.

### POSITION

Support. On November 26, 2002, the Franchise Tax Board voted to sponsor this provision.

### ANALYSIS

FEDERAL/STATE LAW

The federal Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) was signed into law on August 22, 1996. PRWORA provides a strengthened child support enforcement program that locates non-custodial parents, establishes paternity when necessary, and establishes and enforces child support orders. One key provision of the PRWORA legislation related to enforcement of child support orders is a requirement that all states have a program to report information about newly hired and rehired employees timely.

As required under the federal PRWORA legislation, California enacted legislation that requires both a new-hire and a contractor registry. Employers are required to report information on newly hired employees to EDD within 20 days of hiring. The information to be reported includes the employee's name, address, and social security number. This EDD report is generally referenced as the "new-hire registry." The information reported to EDD may be used for specific purposes, such as locating individuals for child support enforcement purposes, administering workers' compensation programs, and verifying eligibility for public assistance. In addition, the information may be provided to FTB for the purpose of tax enforcement.

Similar to the new-hire registry, the "contractor registry" requires a service recipient, who is any individual, person, corporation, or partnership, to report to EDD the name, address, and social security number of the person providing them with a service. A service provider is an individual who is not employed by the service recipient for California purposes, but receives compensation or executes a contract for services performed for the service recipient. Similar to the law for the new-hire registry, the law regarding the contractor registry states that the information obtained by EDD may be provided to FTB for tax enforcement purposes.

FTB is authorized to administer collections for several non-tax programs, including vehicle license fees and court-ordered debts. To collect on non-tax debts, the department is authorized under state law to use the remedies and information sources available for collecting personal income tax debts.

**PROGRAM BACKGROUND**

Although information in EDD's new-hire and contractor registries would be helpful to the department's NTD programs, this information is not currently being used for these purposes because of a lack of clear statutory authority to do so.

The statutes authorizing the department to collect the various non-tax debts contain general authorization for the department to use the same collection remedies and resources available for collecting personal income tax debts. Since these EDD registries are available for collecting income tax debts, it would appear that they could also be used for NTD collection. However, as stated above under "State Law" the provisions regarding the EDD registries state that the registry information may be supplied to FTB for specifically identified purposes, including for the purposes of child support collections and or tax enforcement. The term "tax enforcement" is not defined.

Currently, FTB's child support collections program (CSC) matches its debtor's accounts with EDD's registries on a bi-monthly basis. CSC accounts are sent to EDD electronically and EDD runs a matching process against the registries. Upon completion, EDD returns a tape of "payor" information for those CSC accounts where a match was found. The "payor" information includes the debtor's name, address, and Social Security number, as well as the payor's name, address, Federal and State Employer Identification Numbers, and any contract information for those CSC accounts that have a match with the contractor registry.

<u>THIS BILL</u>

Under this provision, when a law allows the use of information for "tax enforcement" purposes, tax enforcement would include the collection of any amount that is referred to FTB for collection where FTB may use any manner authorized under law for collecting unpaid tax liabilities.

Essentially, since current law allows FTB to use information like the new-hire and contractor data for tax enforcement purposes, this provision would clarify the law to allow FTB to use those same information sources for collection of NTD, which FTB is authorized under law to collect as if a personal income tax.

<u>IMPLEMENTATION CONSIDERATIONS</u>

Since this provision only provides FTB clear statutory authority to access EDD registry information for NTD purposes, implementation of this bill is expected to be minimal and as stated below under "Departmental Costs," the costs to implement this bill are negligible. The cost to update the NTD computer system to be able to participate in a data match with EDD is estimated to be minor, less than $50,000. Under current law, the department's costs to administer NTD programs are reimbursed through the amounts the department collects. If this bill were enacted in 2003, the department anticipates updating the NTD system by the operative date of January 1, 2004, and recovering the costs under the current NTD reimbursement procedure.

**OTHER STATES' INFORMATION**

Phone calls to the appropriate administrative agency and a review of the state government web sites of *Illinois, Massachusetts, Michigan, Minnesota*, and *New York* provided information that these states have new-hire registries as required under federal law. Although the information maintained in the registries are used for child support and welfare programs, none of the states use the registry information for other state collection programs such as income taxes.

**FISCAL IMPACT**

Departmental costs to administer this provision are negligible since this provision would clarify FTB's authority to access EDD's new-hire and contractor registries for NTD purposes.

**ECONOMIC IMPACT**

Collections Estimate

Generally the amounts collected through FTB's NTD programs do not directly impact the General Fund. However, this bill would result in additional amounts collected for the counties through the Court Ordered Debt (COD) program and additional funds for the Department of Motor Vehicles through the Vehicle Registration Collections (VRC) programs administered by FTB.

| Collection Impact<br>Assume Enactment in 2003, Operative January 1, 2004<br>($ Millions) | | | |
|---|---|---|---|
| Fiscal Year | 2003-04 | 2004-05 | 2005-06 |
| Collections Impact | +2.5 | +3.5 | +2.0 |

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Collections Discussion

Experience with the New Hire Registry for Child Support Collections was considered in estimating the impact on collections for COD and VRC. This estimate assumes that this bill would be enacted during the 2003 legislative session and the department would update its NTD systems prior to the January 1, 2004 operative date. Since this bill would not be operational until January 1, 2004, the full impact does not occur until fiscal year 2004-05. Ultimately, the enactment date of this bill determines which fiscal year collections would begin.

The estimates above reflect both new collections that would not occur otherwise, as well as the "acceleration" of collections. Approximately three-quarters of the total collections are attributable to the VRC, and the balance to COD.

**ARGUMENTS/POLICY CONCERNS**

Express authority to allow FTB to use the new-hire and contractor registries to collect NTD would give the department access to employer and wage information that is four to nine months more current than is presently available. Therefore, the department would have the information needed to identify and levy a debtor's wage income on a timely basis.

## 2. Minimum Franchise Tax/15-Day Disregard Rule

**PURPOSE OF THE BILL**

The purpose of this provision is to clarify current law.

**EFFECTIVE/OPERATIVE DATE**

This provision would be operative for taxable years beginning on or after January 1, 2004.

**POSITION**

Pending.

**ANALYSIS**

FEDERAL/STATE LAW

Under federal law, generally every corporation is subject to federal income tax and must file an income tax return for any portion of a tax year that it is in existence, regardless of the amount of gross income or whether it has taxable income. Federal law does not impose a franchise tax.

Under current state law, corporations that incorporate or qualify with the Secretary of State (SOS) and corporations doing business in California are subject to the franchise tax for each taxable year, based on their income for that same year. When incorporation occurs within 15 days or less preceding the beginning of the next annual accounting period and the corporation is inactive (herein referred to as this 15-day inactive period), corporations are not subject to the franchise tax for this 15-day inactive period, though technically, this period is a taxable year. As such, this 15-day period is disregarded for purposes of: 1) filing tax returns, 2) of imposing the minimum franchise tax, and 3) granting tax relief.

THIS BILL

This provision would clarify the law to expressly provide that this 15-day period for which a corporation is not subject to franchise tax would be disregarded as part of a taxable year for purposes of granting taxpayers relief from the minimum franchise tax. This provision codifies Franchise Tax Board's (FTB) interpretation of existing law.

IMPLEMENTATION CONSIDERATIONS

This change would not cause significant problems for the department.

TECHNICAL CONSIDERATION

This bill would refer to the 15-day period as "part of a taxable year." Current law refers to the 15-day period as a "taxable year." Amendment 1 is provided to reflect current law.

**PROGRAM BACKGROUND**

Corporations incorporate or qualify to do business in California through the SOS. Corporations file their tax returns with, and pay the tax to, FTB based on the corporation's income. Generally, tax returns are filed annually for a 12-month period.

A small number of corporations each year incorporate in late December, just prior to the end of their annual accounting period. For example, a taxpayer may incorporate December 16, and may select an annual accounting period that is a calendar year ending December 31. Typically, during this 15-day period corporations are not doing business. These corporations may be establishing their corporate day-to-day administrative practices and procedures, setting up their accounting records, and performing other administrative functions. Incorporating during the latter part of December also prevents a workload bottle-neck at the SOS office each January 2.

Historically, FTB disregarded this 15-day inactive period for purposes of both filing tax returns and imposing the franchise tax. This practice was legislatively clarified in 1997 by adding Section 23114 to the Corporation Tax Law (SB 1106; Stats. 1997, Ch. 604), as follows: A corporation shall not be subject to the taxes imposed by this chapter [the corporation franchise tax] if the corporation did no business in this state during the taxable year and the taxable year was 15 days or less.

For approximately the last 10 years, the minimum franchise tax has been $800. However, relief was granted in the last few years as follows: During 1999, the minimum franchise tax for qualified new corporations was reduced to $300 for amounts then payable to the SOS and $500 for the next taxable year (section 23153, subdivision (e); AB 2798; Ch. 323, Stats. 1998). After 1999, corporations that incorporate or qualify to do business in California on or after January 1, 2000, were relieved fully from the minimum franchise tax that otherwise would have been paid to the SOS and the next taxable year [first income year] (section 23153, subdivision (f); AB 10; Ch. 64, Stats. 1999). With changes to statutory terminology and the elimination of "income year", this relief was revised to provide an exemption from the minimum franchise tax for the first taxable year. For purposes of providing tax relief under these acts FTB disregards this 15-day inactive period as a tax year.

**OTHER STATES' INFORMATION**

The corporate tax laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*, which are six of the larger states, were reviewed. None of these states have a corporate prepaid minimum franchise tax system comparable to California's. In addition, the general corporate filing instructions from these states disclosed no provisions specific to that state's treatment of the above-described 15-days-or-less inactive periods.

**FISCAL IMPACT**

This provision would not increase departmental costs as it merely clarifies the law and codifies current practice.

**ECONOMIC IMPACT**

Revenue Estimate

This provision would not affect state tax revenue as it merely clarifies the law.

**LEGISLATIVE STAFF CONTACT**

| | |
|---|---|
| LuAnna Hass | Brian Putler |
| Franchise Tax Board | Franchise Tax Board |
| 845-7478 | 845-6333 |
| LuAnna.Hass@ftb.ca.gov | Brian.Putler@ftb.ca.gov |

Analyst LuAnna Hass
Telephone # 845-7478
Attorney Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1742
As Amended April 22, 2003

AMENDMENT 1

On page 4, line 5, strikeout "as part of"